

ALTERNATIVE FORECASTS

DRI has assigned a 55% probability of occurrence to its March 2000 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP grows by 4.1% in 1999, 4.4% in 2000, 2.9% in 2001, 3.2% in 2002, and 3.1% in 2003;
- U.S. nonfarm employment advances 2.2% this year, 2.2% next year, 1.4% in 2001, then growth averages 1.2% thereafter;
- the U.S. civilian unemployment rate remains below the full employment rate of 5.5%;
- consumer confidence peaks in 2000, then slowly tapers off over the forecast period;
- consumer inflation remains tame;
- the federal budget surplus increases in each year of the forecast;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed the economy will not suffer a recession over the forecast period, it should be noted the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and its probability of occurrence is 55%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 45%. This implies the chances of the economy not suffering a recession over the next few years are barely better than even.

PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has been assigned a 10% probability of occurrence. A major feature of this scenario is the economy turns south more quickly than in the *Late-Recession Scenario*. An early recession is possible if consumer confidence erodes because of a tumbling stock market. In such a scenario, oil prices jump further, shaking both consumer and investor confidence. Worried about the impact of high oil prices and tight labor markets, the Federal Reserve hikes interest rates more sharply than in the baseline. The jump in interest rates, combined with rising energy costs, scares investors and turns the bull market bearish. Consumers are frightened by their loss of wealth and layoffs, causing spending to retrench. Business investment drops, undermined by the higher costs of equity and debt capital. The slump worsens as South America's fragile expansion fades and Asia's recovery stalls.

The still-low inflation allows the Federal Reserve to cut interest rates sharply. As a result, the recession is relatively mild. Moreover, the economy rapidly regains its pre-recession peak. This would be a unique recession. No stock market crash has ever been able to cause a recession without the accompaniment of tight monetary policy and rising inflation. In addition, no postwar expansion has ever ended before inflation climbed above 4.0%.

The impact of this national scenario on the Idaho economy is summarized here. The Gem State's economy would grow slower than in the baseline case in 2000 and 2001. Idaho nonfarm employment

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
APRIL 2000

	BASELINE				PESSIMISTIC				LATE RECESSION			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
GDP (BILLIONS)												
Current \$	9,255	9,789	10,234	10,758	9,255	9,725	9,833	10,410	9,255	9,804	10,340	10,555
% Ch	5.6%	5.8%	4.5%	5.1%	5.6%	5.1%	1.1%	5.9%	5.6%	5.9%	5.5%	2.1%
1992 Chain-Weighted	8,131	8,488	8,733	9,009	8,131	8,418	8,393	8,769	8,131	8,494	8,770	8,739
% Ch	4.1%	4.4%	2.9%	3.2%	4.1%	3.5%	-0.3%	4.5%	4.1%	4.5%	3.3%	-0.4%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	27,836	29,889	31,662	33,573	27,836	29,844	31,124	32,921	27,836	29,910	31,903	33,733
% Ch	7.5%	7.4%	5.9%	6.0%	7.5%	7.2%	4.3%	5.8%	7.5%	7.5%	6.7%	5.7%
U.S. (Billions)	7,791	8,281	8,713	9,148	7,791	8,262	8,492	8,879	7,791	8,287	8,788	9,156
% Ch	5.9%	6.3%	5.2%	5.0%	5.9%	6.0%	2.8%	4.6%	5.9%	6.4%	6.1%	4.2%
PERSONAL INCOME - 1992 \$												
Idaho (Millions)	24,409	25,723	26,761	27,737	24,409	25,598	26,226	27,326	24,409	25,725	26,837	27,543
% Ch	5.8%	5.4%	4.0%	3.6%	5.8%	4.9%	2.5%	4.2%	5.8%	5.4%	4.3%	2.6%
U.S. (Billions)	6,832	7,135	7,372	7,566	6,832	7,095	7,164	7,379	6,832	7,135	7,401	7,484
% Ch	4.2%	4.4%	3.3%	2.6%	4.2%	3.9%	1.0%	3.0%	4.2%	4.4%	3.7%	1.1%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	539.6	557.7	569.6	583.5	539.6	556.2	559.9	574.2	539.6	557.7	570.5	579.4
% Ch	3.5%	3.4%	2.1%	2.5%	3.5%	3.1%	0.7%	2.6%	3.5%	3.4%	2.3%	1.6%
U.S. (Millions)	128.6	131.5	133.3	134.9	128.6	131.1	129.7	131.2	128.6	131.5	133.7	133.1
% Ch	2.2%	2.2%	1.4%	1.2%	2.2%	1.9%	-1.0%	1.1%	2.2%	2.2%	1.7%	-0.5%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	113.9	117.4	118.7	121.5	113.9	116.7	114.2	118.3	113.9	117.5	119.1	118.1
% Ch	2.4%	3.1%	1.1%	2.4%	2.4%	2.4%	-2.2%	3.6%	2.4%	3.1%	1.3%	-0.8%
U.S. (Millions)	25.2	25.3	24.8	24.5	25.2	25.2	23.9	23.6	25.2	25.3	25.0	24.0
% Ch	-0.4%	0.2%	-1.8%	-1.2%	-0.4%	-0.2%	-5.3%	-1.2%	-0.4%	0.3%	-1.2%	-3.9%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	425.6	440.3	450.9	462.0	425.6	439.5	445.8	455.9	425.6	440.3	451.5	461.3
% Ch	3.7%	3.4%	2.4%	2.5%	3.7%	3.3%	1.4%	2.3%	3.7%	3.4%	2.5%	2.2%
U.S. (Millions)	103.4	106.2	108.5	110.4	103.4	105.9	105.9	107.6	103.4	106.2	108.7	109.1
% Ch	2.9%	2.7%	2.2%	1.7%	2.9%	2.4%	0.0%	1.6%	2.9%	2.7%	2.4%	0.3%
FINANCIAL MARKETS												
Federal Funds Rate	5.0%	6.2%	6.5%	5.9%	5.0%	6.4%	6.3%	5.4%	5.0%	6.0%	7.0%	7.8%
Bank Prime Rate	8.0%	9.2%	9.5%	9.0%	8.0%	9.4%	9.4%	8.5%	8.0%	9.0%	10.0%	10.8%
Mort Rate, New Homes	7.1%	8.0%	8.0%	7.7%	7.1%	8.1%	8.4%	8.0%	7.1%	8.0%	8.1%	8.6%
INFLATION												
GDP Price Deflator	1.4%	1.5%	1.6%	1.9%	1.4%	1.6%	1.4%	1.3%	1.4%	1.5%	2.2%	2.4%
Personal Cons Deflator	1.6%	1.9%	1.8%	2.3%	1.6%	2.2%	1.8%	1.5%	1.6%	2.0%	2.2%	3.0%
Consumer Price Index	2.2%	2.4%	2.2%	2.5%	2.2%	2.8%	2.1%	1.5%	2.2%	2.5%	2.7%	3.4%

Forecast Begins the FOURTH Quarter of 1999

would advance 3.1% this year, but growth would be a meager 0.7% in 2001. In the baseline case, this measure would rise by 3.4% in 2000 and 2.1% in 2001. Employment growth would pick up speed in 2002, but would not be fast enough to offset the two previous slow growth years. By 2002, Idaho nonfarm employment would be 574,200, which is over 9,000 less than its baseline counterpart. Idaho real income would follow a similar pattern in this scenario. Its growth would fall below the baseline base this year and next, causing the level of real personal income to be well below its baseline counterpart.

LATE-RECESSION SCENARIO

The *Late-Recession Scenario* has been assigned a 35% probability of occurrence. In this scenario the Federal reserve is slow to react to rising inflationary pressures. When it does react, it does so severely, and with disastrous results. Indeed, signs of rising inflation are already surfacing. Oil prices are jumping and employment costs are moving up. There is a real possibility of stronger-than-anticipated growth overseas. Should this occur, commodity prices, including oil, could rise further. If oil prices surge again in 2001, consumer price inflation could rise above 4.0%. Most importantly, a shortage of workers will continue to put pressure on wages. Combined with higher health-care costs, the result would be rising unit labor costs notwithstanding still-strong productivity gains. Under this scenario, inflation hits 4.2% in early 2002.

As the core inflation rate rises, the Federal Reserve is expected to push the federal funds rate to 8.0%. The stock market crashes in response to rising rates and the reappearance of inflation. It is assumed that stocks plunge 40% from their late-2001 peak to the end of 2002. As a result of this turmoil, consumer confidence evaporates. The economy falls into a recession. Fortunately, the Federal Reserve has learned from its previous mistake and reacts quickly to the downturn. As a result, the recession is about average by historical standards. The economy recovers quickly from this recession, but even by 2003, real GDP is not yet back to its baseline level.

The most significant differences between this scenario and the baseline occur in 2002. As the accompanying table shows, up to that year, both Idaho nonfarm employment and real personal income levels are close to their respective baseline counterparts. However, the gap between these measures would widen in 2002 as a result of the recession. Idaho nonfarm employment would rise just 1.6% in that year to 579,400. In comparison, it increases 2.5% to 583,500 in the baseline in 2002. Real personal income would be \$27.5 billion in 2002 in the *Late-Recession Scenario*. It is \$27.7 billion in the baseline case.